Defying the liberal model from within: the case of Hungary in the EU

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Abstract:

The entrenchment of an illiberal system in Hungary under Viktor Orban has remained a puzzle given the EU’s legal provisions enshrining liberal values as well as the high popularity the Union enjoys among Hungarians. This paper attempts to explain this overt contradiction by drawing on Putnam’s two-level game theory whereby Orban has to maintain favorable win-sets at both the domestic and the European level in order for his illiberal system to survive. At the domestic level, Orban has been able to decrease the size of his win-set by exploiting moments when liberal values appeared to be in crisis, allowing him to entrench narratives denouncing such values and offering an illiberal alternative. At the European level, the “neo-medieval” institutional set-up of the EU proved enabling for Orban, permitting him to enlarge his win-set with respect to European interlocutors without facing effective sanctions. The analysis not only highlights the relevance of ideational approaches in IR but also underlines that the power of narratives to reach certain political goals is constrained by underlying fundamentals which are recognized by the Orban regime and ignored by others such as the Tsipras government in Greece.
Introduction

After the collapse of communism, Hungary had some of the most favorable conditions for a transition to a liberal democratic system and a market-based economy. Having embraced a partly liberalized economic system dubbed “Goulash Communism” since the early 1980s and being the first Eastern-bloc country to physically tear down the Iron Curtain, a convergence with Western European states appeared promising. Despite an ambitious reform agenda and swift EU accession in 2004, Hungary turned out to be the first post-communist member state to experience major democratic backsliding. Since coming to power in 2010, Fidesz under Viktor Orban has been systematically transforming Hungary into a semi-authoritarian state with strong elements of economic nationalism. The “system change” has gone so far that Freedom House downgraded Hungary to “partly free” in 2019, making it the only EU member in this category. This transformation was neither concealed, with Orban openly advocating for illiberal democracy in 2014, nor was it met with a lot of resistance from European states or the EU for years. The latter is surprising given that key principles such as “equality,” “the rule of law” and “market economy” enshrined in Articles 2 & 3 of the Treaty of the European Union have been under serious attack in Hungary. The EU only started reacting belatedly to these fundamental challenges and infringement procedures have proven toothless so far. The scene when European Commission President Juncker awkwardly greeted Orban with the words “Hello, Dictator” at a 2015 EU summit in Riga is quite telling: Hungary’s political and economic divergence from the liberal democratic model of the EU was a fait accompli and there was little the EU was willing or able to do about it.

Just as surprising as the EU’s timid response, is the observation that Hungary’s departure from the liberal model has coincided with a consistently high and increasing popular approval of the EU. Among the Visegrad-4 (V-4), Hungarians’ attachment to the EU is only second to Poland and overall one of the highest values in the EU. At the same time, Orban’s approval ratings have followed a parallel trend to the EU as seen in Figure 1. The inconsistency here is more than obvious since it is hard to rationalise how people can become simultaneously more supportive of the EU as well as institutions contradicting its very values and laws. Therefore, the question that needs to be raised is the following: How is it possible that Hungary has been able to exist as an illiberal state within a liberal Union that remains very popular in the country?

2 Eurobarometer (2018).
I suggest that the answer to Hungary’s persistent divergence from the EU political and economic model can be found at the intersection of two different levels, the domestic and the EU level. Abstracting somewhat from Putnam’s two-level game theory, Orban’s ability to pursue his desired course at home without having to make concessions to the EU relies on a very favorable bargaining position which combines a narrow win-set at the domestic level with a wide win-set at the EU level. The narrow win-set at the domestic level is the product of clever political entrepreneurship which took advantage of moments of crises to entrench a powerful narrative justifying the construction of illiberal institutions and reconciling these with EU membership. The wide win-set at the EU-level is a result of the non-hierarchical (“neo-medievalist”) structure of the EU which is both enabling and unconstraining. In essence, the intersection of the domestic “demand-side” and the EU “supply-side” result in an equilibrium allowing Hungary to maintain a political and economic model in defiance of EU laws and values. This approach not only shows that success at both levels was necessary for Orban to achieve his desired outcome. It also demonstrates that while narratives at the domestic level are important for explaining the creation of divergent institutions, these are confined by fundamental conditions at the EU level.

To prove this thesis, the overarching two-level theory will first be laid out briefly. Then, the domestic level will be discussed and illustrated on the basis of two moments of crisis, the 2008 Financial Crisis and the 2015 refugee crisis. Finally, the EU level will be described through the lens of Zielonka’s neo-medievalism. In what follows, I define “illiberal democracy” as a system that is only nominally democratic and where basic hallmarks of democracy such as the rule of law, free media and the protection of minority rights are not respected. Economic nationalism is defined in the Listian sense as proposing state intervention to benefit national economic agents at the expense of foreign economic interests. I will use “Fidesz” and “Orban” interchangeably following Mihalyi who suggests that all decisions by Parliament and the government reflect Orban’s personal decisions in today’s Hungary.3

**Two-level game approach**

Robert Putnam’s two-level game theory was conceived as a framework to analyse the outcome of international negotiations. His key insight was that the national political leaders had to

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3 Mihályi (2017), 4-5.
balance interests of domestic and international stakeholders. The eventual result of this interaction will depend on how constrained the national leader is at home and vis-à-vis the international negotiating party. Putnam uses the notion of “win-sets” to illustrate the constraints of negotiators at both levels. In order for a deal to be made, win-sets of both levels need to overlap. In the case of overlap, it is the relative size of win-sets that determines the distribution of gains to the negotiating partners. For the purpose of this essay, it is important to note that small domestic win-sets are considered a bargaining advantage as international negotiators will be unable to exert a lot of pressure in order not to obtain a deal that cannot be upheld at the domestic level. On the flipside, a large perceived win-set of the counterparty means that the international negotiating partner will be willing to make generous concessions.4

The above framework can be adapted to the case of Hungary and the EU if one abstracts away the physical negotiation of one deal but rather sees it as an ongoing game determining policies and institutions. Orban’s preferred outcome is an illiberal state and heavy state intervention in the economy. The EU’s preferred outcome is for Hungary to abide by EU values and laws. What are the possible outcomes of the two-level game? Three stylized outcomes are possible:

1. Two win-sets of equal size for Hungary and the EU means concessions on both sides, possibly some minor transgression but no full abandonment of liberal democracy by Hungary.
2. A larger win-set for Hungary means that the EU has very effective sanctioning mechanisms making sure Hungary complies with EU laws.
3. A smaller win-set for Hungary means that it will be able to maintain an illiberal system violating EU laws with no effective sanctions from the EU.

Clearly, outcome 3 comes closest to what is observed in reality. The question is how one can explain Hungary’s small win-set with respect to the EU. According to Putnam, national leaders have the possibility to manipulate their domestic win-set and will have an incentive to tighten it by rallying support for their position from their constituents.5 Orban appears to have done just that by creating a narrative rejecting the liberal model in moments when the latter appeared to be in crisis. The EU, on the other hand, was unable to credibly diminish the size of its win-set due to its unconstraining structure. The game’s equilibrium, therefore, was heavily skewed towards Hungary’s preferred outcome (see Figure 2). The following sections will discuss the mechanics at the domestic and the EU levels in detail.

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5 Ibid., 450.
Domestic level: narratives give rise to illiberal institutions

Mainstream IPE has for the most part offered explanations in line with a rational-actor model which sees decision-makers as making choices based on their well-defined interests under certain constraints\(^6\). Interest groups, given their role in the economy, know that certain outcomes will maximize their welfare and try to achieve these by taking appropriate actions in the political arena. For instance, such a framework allows analysts to neatly derive economic actors’ interests owing to the factor of production they represent in an economy with a given resource endowment. This in turn explains which coalitions will come to dominate at the political level and which institutions they will impose.\(^7\) While such theories are parsimonious and seemingly transferable across different contexts, they are challenged in many instances when agents act contrary to what should be their objective material or professed interest as in the case at hand. One likely reason for the break down of such approaches is the strong assumption they make about policymakers knowing “how the world works.” In reality, however, interests are not naturally determined by objective categories but rather the worldviews that actors hold will determine their policy preferences and political behaviour.\(^8\) This crucial intervening variable can be summarized as “ideas.”

Indeed, ideas have recently been increasingly appreciated as explanatory factors as to why economic institutions differ substantially across countries.\(^9\) One such account by Mukand and Rodrik emphasizes the importance of political entrepreneurs who attempt to persuade the public of the need for a new institution or policy by stressing ideas about how the world has changed as well as people’s identities. The latter form of ideational politics is known as “identity politics” which send messages about who is a native or an outsider, disseminate racial stereotypes about religious or ethnic minorities and constantly cite national identity in policy discussions.\(^10\) By creating persuasive narratives based on such identity considerations, political entrepreneurs can raise the salience of a given identity in society and may distort voter preferences such that they no longer conform with their objective interest. For instance, low-income voters may support a policy favoring the high-income minority if their sharing an identity with the high-income minority is perceived as more salient to them than a loss in

\(^6\) Rodrik (2014), 190.
\(^7\) Rogowski (1989).
\(^8\) Rodrik (2014), 192-4.
\(^9\) Abdelal, Blyth and Parsons (2010), 2-5.
\(^10\) Mukand and Rodrik (2018), 1-2.
material wealth.\textsuperscript{11} This effect is further reinforced if a narrative based on identity is complemented by a narrative about how the world works since the latter will act to further convince voters of the desirability of a given policy. In the context of the previous example, a complementary worldview narrative would suggest that on top of the benefit derived by the low-income group from association with the high-income group identity, the policy will also not have any downside for the low-income group.

Ideas play an especially powerful role as a signpost for policies during times of crises. According to Blyth, this is so because interests are underdetermined in times of Knightian uncertainty when no probabilistic statements about outcomes can be made, which crucially differs from conventional risk. Hence, it is ideas about the functioning of the economy and not interests that provide blueprints for institutions.\textsuperscript{12} “[C]risis-defining ideas not only tell agents ‘what has gone wrong’ but also ‘what is to be done’” and thus allow policymakers to set normative limits on the institutional forms destined to address the uncertainty.\textsuperscript{13} In this sense, crises create a moment in time when political entrepreneurs should find it easiest to sell their worldview and identity-based narratives to society.

The preceding discussion makes clear why an ideational approach is especially suitable to explain the domestic “demand-side” for illiberal institutions in Hungary. A rational-actor approach would struggle to explain the apparent tension between the objective benefits that large strata of Hungarian society derive from EU membership and the concurrent support for policies that contradict EU values and even laws. Additionally, in the absence of ideational variables, it is difficult to see how popular support for Orbán as well as the EU could increase at the same time when they represent diametrically opposed policies and institutions. Therefore, the domestic story will likely feature ideas that interfere with the material preferences of actors. In particular, I argue that Orbán took advantage of two moments of crisis, namely the 2008 Financial Crisis and the 2015 refugee crisis, to entrench a narrative that rejects liberal institutions and justifies the construction of what he calls “illiberal democracy” and its economic counterpart economic nationalism. Both crises were accompanied by ideas put forward by Fidesz which combined a certain view of the world and arguments about identity allowing the party to resonate well with voters. The messaging was carefully calibrated to ensure that a dismissal of liberal values and criticism of EU institutions could be reconciled

\textsuperscript{11} Ibid. 5.
\textsuperscript{12} Blyth 2002, 11.
\textsuperscript{13} Blyth 2007, 762.
with overall support for the idea of a united Europe, which both Orban and his voters still endorse.

The 2008 Financial Crisis

Given the severity with which the 2008 Financial Crisis hit Hungary, it is unsurprising that this provided a favourable backdrop against which political entrepreneurs could create a strong narrative against established institutions. Hungary saw the worst crisis performance of the Visegrad-4 with GDP contracting by 6.5% in 2009. Even more problematic for consumers, however, was the high level of household foreign-currency debt which had grown from a mere 5% to 70% of total loans outstanding within only five years. Such loans became very difficult to service once the forint weakened drastically.\(^\text{14}\) To make matters worse, the Western European banks, which dominated the financial service sector in Hungary, came under stress in their home markets and thus faced pressures to “cut and run.”\(^\text{15}\) Given Hungary’s relatively high external debt burden, such an outflow would not only threaten the country’s financial stability but also liquidity. Hungary soon faced serious balance of payments issues and therefore had to agree to a €20 billion loan from the IMF, EU and World Bank in November 2008. The conditions attached to the loan included real cuts in public wages and pensions as well as the elimination of the 13-month salary for public employees.\(^\text{16}\) While the conditionality appears to be quite mild, the need for the Socialist government under Gyurcsany to impose pro-cyclical austerity measures, having explicitly run on a platform promising no fiscal tightening, enraged voters and invited criticism from opposition parties like Fidesz.

To underline how dire the crisis was perceived by Hungarians, a poll conducted in 2009 suggested that 72 percent of respondents felt they had been better off under communism.\(^\text{17}\) The crisis seemed to have induced a general sense of disillusionment with democracy as 77 percent of Hungarians declared that they were dissatisfied with democracy – the highest figure in a former Eastern bloc country in 2009.\(^\text{18}\) This circumstance that a decline in material well-being was accompanied by a drop in support for democratic institutions is unsurprising given that

\(^{14}\) Johnson and Barnes (2015), 543.
\(^{16}\) Eger Akos (2015), 12.
\(^{18}\) Ibid.
democratization had been explicitly linked to economic growth (and likely been oversold) by leaders after the collapse of communism. Indeed, democratic and market reforms seemed to go hand in hand. Therefore, people in Eastern Europe came to conflate markets and democracy and blamed the two for the decrease in their living standards. A backlash against neoliberal economics is, of course, not a new reaction to deep economic crises. Polanyi famously argued that societies would protect themselves against the most adverse side-effects of markets through what he called a “countermove.” In his view, manifestations of such a countermove include fascism and socialism of the 1930s which were both “rooted in a market society that refused to function.” After World War Two, the protective function against global market forces was carried out by the Bretton Woods system which was deliberately designed to allow for global trade while at the same time giving states domestic discretion in economic policymaking so as to cushion societies against external disruption. This concept of “embedded liberalism” was a purposeful reaction by leaders who had drawn the lessons from the disastrous experience of the interwar years. Importantly, this shows that the institutions created to mitigate economic uncertainty are not predetermined but depend on which idea for a “countermove” take the day. Orban’s program resonated well with Hungarian voters in the aftermath of the 2008 crisis as it offered a clear story about who was to blame for the economic hardship and what could be done about it. According to Rodrik, it is this aspect of populism that makes it so appealing in response to economic dislocation as it offers solutions and meaning to the complex of problems of globalization that are otherwise hard to come by. The narrative created by Fidesz was especially powerful as it played on both a changed state of the world as well as Hungarian identity. First, the view of the world put forward by Orban maintained that the 2008 Financial Crisis had laid bare that the liberal order and Western values were in decline. Liberalism did not hold its promise of creating prosperity as “[t]he Hungarian liberal democracy that had developed was incapable of implementing a good many things.” The liberal state was unable to protect Hungary from falling into debt and failed to insulate families from the devastating effects of foreign currency loans. In contrast to this liberal model stand states such as China, Russia and Turkey – the “stars” of today’s world economy according to Orban – who all embrace illiberal systems with heavy state intervention in the economy. China’s crisis

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21 Polanyi (2001 [1944]), 248.
22 Ruggie (1982).
performance was particularly impressive with its economy growing by almost 9% in 2009 while the American economy contracted by 2.6% that year. A key aspect that seemed to give these illiberal systems a competitive edge was the effective absence of veto players such as a judiciary or free media which allowed for streamlined, rapid decision-making. Another appeal is that the economy in these states is not seen as a means to enrich individuals but rather to advance the overall national interests. Orban presented such an illiberal model based on pervasive state involvement as a viable alternative to what he saw as failing Western capitalism in Hungary. This would allow Hungary to better compete in the global economy and achieve higher economic growth. Hence, Orban made it very clear what his remedy to Hungary’s economic difficulties was and thus he declared “the new state that we are constructing in Hungary is an illiberal state.”

There was also a strong identity-based element within Orban’s narrative which further reinforced his idea of an “illiberal turn.” National identity plays an important role for Hungarians given their ability to maintain a distinct identity in the face of numerous historical defeats and the location of their motherland which they see as trapped between Germans and Slavs without any kith or kin. Orban’s rise has been accompanied by an intensification of nationalist sentiments which he ably tapped into for political mobilization. A revisionist portrayal of Miklos Horthy as defender of the nation as well as discourse surrounding a desire to redress the Treaty of Trianon have allowed Fidesz to present itself as the “savior” of the Hungarian nation from “outsiders.” These “outsiders” include foreign companies whose interests dominate the Hungarian economy according to Orban. Strategic assets – particularly banks – had been “wrongly sold off” to foreigners and should return to domestic ownership. Orban also blamed foreign-owned banks for flooding Hungary with foreign-currency loans and therefore suggested that at least half of the sector be in Hungarian hands. In this context, Orban made clear that “we had had enough of the politics that is forever concerned with how we might satisfy the West, the bankers, big capital and the foreign press…Hungary will not succumb again!”

29 Voszka 2016, 5-6.
The fact that the narrative created in the post-crisis environment proved essential in establishing illiberal institutions is demonstrated by the ease and speed with which the “system change” was carried out. Within only twenty months of coming to power in 2010, Fidesz carried out a “U-turn” whereby democratic institutions that had been nurtured since 1989 were rolled back and the economy was no longer compatible with a modern market economy. A new “Fundamental Law” was passed by parliament making it more difficult to overturn laws introduced by Fidesz in the future. Further, the constitutional court was stacked with Fidesz-loyalists after judges above 62 years of age were forced to retire. A highly problematic media law was passed in 2010 which created a media supervisory authority under the de facto control of Fidesz which had the ability to silence disliked media outlets by issuing high financial penalties. New laws like these were hardly debated in or outside of parliament, yet they were passed at such a high pace that parliament effectively turned into a “law factory.” The EU challenged both the forced retirement of judges as well as the media law, and it was ruled that Hungary had to amend these laws. While Orban had to back-paddle officially, this hardly changed the situation on the ground as the constitutional court and media remained close to Fidesz.

In the economic realm, the narrative casting state intervention in a positive light while demonising foreign ownership allowed for policies that not only conflicted with market economic principle prescribed by the EU but in some instances also went against the material interests of Hungarians. The attack on foreign-owned banks is a clear example of this. In 2010, Fidesz introduced a bank levy of 0.6% on financial assets which was one of many taxes the government rolled out to balance its fiscal handouts in the form of a flat income tax rate. As the bank levy was based on financial assets – not profit – it was clearly directed against Western banks whose subsidiaries made up five of Hungary’s six largest banks. While the provision destroyed banking profits for years to come, allowing the government to purchase the subsidiaries of GE Capital and Bayrische Landesbank, it also had a very negative side-effect on Hungarian consumers and businesses as the levy effectively discouraged lending which plummeted substantially since 2010 (see Figure 3). To stop the slump in lending and foreign investment, Orban agreed to a “truce” with the banking sector in 2016 pledging to phase out the bank levy in return for increased lending. Another instance of economic nationalism hurting Hungarians was the rejection of IMF standby loans to address Hungary’s high

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32 Kornai (2015), 279.
33 Bozoki (2011), 653.
34 Kornai (2015), 281.
government debt and persistent deficits. Orban was determined to rather accept high borrowing costs in bond markets than to give in to IMF tutelage. Despite receiving a junk rating on government bonds in October 2012, the Hungarian government decided to return to the bond market in early 2013. Although Johnson and Barnes rightly point out that the yields from the issuance exceeded expectations, a premature repayment of the IMF loan required other measures that were even more detrimental to Hungarian taxpayers. The most significant of such revenue-generating measures was the nationalization of private pension funds which immediately raised $14 billion for the government and eased pressure on the budget. Yet this act represents massive state intervention in the economy and a “robbery of 3 million citizens.”

Economist András Inotai highlights while such a measure “would have led in any other state mass protests and possibly removal of the government… [t]he response of the Hungarian public was silence and apathy.” Indeed, the implicit consent does seem to suggest that the narrative created by Fidesz did persuade the Hungarian public of the desirability of pursuing a path diverging from the liberal European model.

It is noteworthy that despite the clear violation of EU values and laws, the Hungarian government went to great lengths to portray its actions to be fully compatible with the spirit of the EU. In a speech in July 2014, Orban underlined: “I don’t think that our European Union membership precludes us from building an illiberal new state.” He also decidedly rejected the possibility of leaving the EU as “dangerous and extremist.” This points to Fidesz calibrating its narrative so as not appear “anti-EU” thereby coming into conflict with the widespread support for the Union in Hungary.

**The 2015 refugee crisis**

The massive influx of refugees and migrants in Hungary over the course of 2015 represents another moment of crisis that provided a fertile backdrop against which Fidesz was able to reinforce its illiberal and nationalist narrative. As in the aftermath of the financial crisis, the

38 Johnson and Barnes (2015), 555-8.
39 Lendvai (2017), L.1715.
40 Ibid.
41 Djankov (2015), 5.
government framed the crisis by playing to national identity and disseminating a worldview – that is migrants pose a threat to Hungarian Christian identity and economic welfare. Aided by state-controlled media, the narrative rationalising the crisis resonated with the Hungarian populace and justified policies that severely clashed with EU values and rules, especially the respect for human rights.

The suspicion that the refugee crisis was used by Orban to facilitate a purposeful act of political entrepreneurship is highlighted by the fact that he ramped up anti-immigrant rhetoric months before Hungary experienced large inflows of refugees. It was in January 2015 in the course of the solidarity march for victims of the Charlie Hebdo attack that he first publicly declared “zero tolerance against migrants” and that “we do not want to see in our midst any minorities whose cultural background differs from our own.” Interestingly, the initial arguments put forward against immigrants were not identity-based but rather emphasized the view that migrants threaten citizens’ economic welfare as they stole jobs from Hungarians. Billboards reading “If you come to Hungary, you must not take jobs away from Hungarians!” appeared across Hungary. The fact that these billboards were written in Hungarian is not only ironic as they were certain to miss their intended targets, but also show that such fear-mongering was directed at a domestic audience to establish a certain worldview. There is, however, little doubt about the effectiveness of this campaign as 82% of Hungarians feared losing their jobs and social benefits to immigrants against a 50% European average.

From March 2015 onwards, “the security and identity axes supplanted the economic axis.” Government rhetoric began associating migrants with terrorism and portrayed Islam as a threat to Hungary’s ethnic homogeneity. This obsession with preserving Hungarian traditions and rejecting multiculturalism again refers back to the Hungarian foundational myth of a victimized nation and its will to survive. In this context, Hungary’s strong Christian identity is also utilized as a marker for the “in-group” as opposed to the Muslim, non-European “out-group.” The oft-cited “invasion of illegal immigrants” is thus an obvious reference to the medieval Turkish invasion of Hungary. Centuries later, the role of “defender of European civilization” again falls to Hungary. “Without the protection of our Christian culture we will lose Europe, and Europe will no longer belong to the Europeans,” said Orban in March 2019. Like the economic dimension, the identity-based rhetoric seems to have gained traction among the Hungarian

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43 Lendvai (2017), L.2727.
44 Szalai and Göbl (2015), 20-1.
46 Szalai and Göbl (2015), 20.
populace, as xenophobia directed against Muslims reached a European high in 2016 (see Figure 4). The fact that the non-Hungarian born population amounts to a mere percent demonstrates how powerful the narrative alerting against mass immigration was.

Policies of the Hungarian government in response to the refugee crisis clearly conflicted with EU values and laws. In 2015 Hungary started constructing a border fence with Croatia, a fellow EU member state, and Serbia. Draconian laws governing the entry of migrants into Hungary were passed which restricted entry points to transit zones which have been widely criticized for unacceptable sanitary conditions. Furthermore, the number of immigrants allowed to enter is limited to one person a day per transit zone. At the same time, Hungary has been reluctant to accept refugees under an EU quota which has led the EU to initiate an infringement procedure against Hungary. Orban retaliated by holding a referendum in 2016 which asked, in a very suggestive manner, whether the EU should be allowed to re-settle refugees in Hungary without government consent. While the EU quota was decisively rejected by Hungarian voters, such initiatives carry the clear hallmarks of illiberality as a vote of the “pure people” is believed to justify the violation of minority rights.

Switching to the offensive, the Hungarian government then started a devastating media campaign, first against Hungarian-born philanthropist George Soros, then against EU Commission President Jean-Claude Juncker who were both accused of planning to channel migrants to Hungary. This was an unprecedented frontal attack by a member government against EU institutions and caused outrage within the Union. Attempting to square the circle, Orban still tried to stress that his rhetoric was not to be understood as anti-European. To the contrary, the fact that the “EU is more popular in Hungary than any other member state “also reflects the efforts of the Hungarian government, as it is pro-European.” In addition, the “Stop Brussels” slogan “is not anti-European,” according to Orban, and merely seeks to express a desire to “maintain the current allocation of competences between the Member States and the Brussels institutions.”

Besides transgressing liberal political values, Orban’s restrictive immigration policy is also another instance of economic nationalism which appears to be damaging to the Hungarian economy. With fertility rates in decline since the 1980s and 600,000 Hungarians working

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49 Ibid.
abroad, the Hungarian labor market has tightened considerably over the past years.\textsuperscript{50} The labor shortage is especially acute in the industrial sector where 93\% of companies were reporting bottlenecks due to vacant positions in 2018.\textsuperscript{51} Orban’s refusal to ease such pressures by having immigrants fill the void has only worsened the labor shortfall. One response of the Hungarian government was to incentivise Hungarians to have more children by offering generous benefits amounting to 4\% of GDP. Another was passing a law – dubbed the “slave law” – allowing employers to require employees to work up to 400 hours of overtime a year which is only has to be compensated within three years.\textsuperscript{52} The effectiveness of these measures is, however, more than questionable as increasing fertility rates is a long-term solution at best whereas the “slave law” has already been met with large-scale protests. The apparent short-term fix of facilitating immigration is of course irreconcilable with the illiberal narrative that the government has been pushing for years. Nevertheless, the unsustainable demographics could be a fault line where sticking to the illiberal narrative may become too costly politically and economically and back-paddling may be required.

In summary, the “demand-side” of illiberal institutions in Hungary was a product of Fidesz political entrepreneurship in two moments of crisis where a narrative was created to give meaning and lessen uncertainty. In case of both the 2008 Financial Crisis and the 2015 refugee crisis, ideas were conveyed pointing to deep flaws in the liberal political and economic model while presenting national identity as an alternative guiding principle for Hungary. The entrenched narrative justified the need for illiberal institutions and economic nationalist policies which in many instances conflicted with the material preferences of Hungarians. Yet, the government portrayed itself to operate line with the spirit of the EU which remained popular in Hungary.


\textsuperscript{51} Hopkins and Shotter (2018a), https://www.ft.com/content/609e64c4-03a3-11e9-99df-6183d3002ee1.

The EU level: a permissive structure allows for political and economic divergence of member states

On top of the domestic level where Fidesz controls the ideational space suggesting the creation of an illiberal interventionist state, there is a complementary “supply side” story at the EU level which has been enabling Hungary’s divergence from the liberal democratic model. Permissive support structures derived from EU membership paired with weak disciplining mechanisms have allowed Orban to consolidate illiberal institutions as well as state intervention along economic nationalist lines while escaping binding sanctions. Hence, the EU’s favorable institutional set-up has in many ways been enabling for Orban despite a professed desire by the EU Commission and several MEPs to punish the Hungarian government. What makes the EU so powerless in the face of defiance of the center? A concept that seems an appropriate illustration of the Union’s unconstraining nature is Zielonka’s idea of the EU as a neo-medieval empire. Unlike the Westphalian state where a top-down structure sets down the rules for the entire population, the EU rather resembles the territorial organization common in the Middle Ages when an absence of a hierarchical structure and monopoly of law-making were the norm. The center of a medieval empire was often weak and had no monopoly over the legitimate means of coercion. At the same time, sub-units had multiple allegiances and fuzzy administrative, economic and cultural boundaries. Zielonka, however, saw these overlapping circles of governance not as a potential weakness of the Union but rather he viewed the flexibility that a neo-medieval empire provided as a way of making European integration work as the EU expanded. Fifteen years after the EU’s most recent enlargement round, it seems as though neo-medievalism has allowed for legal, political and economic loopholes which have allowed politicians like Orban to openly defy EU rules and norms at home while still getting away with it in Brussels.

In terms of legal enforcement mechanisms, the EU Commission resembles a rather weak medieval center unable to uphold the law across its entire territory. The Hungarian case demonstrates that Brussels is simply lacking appropriate legal tools to confront member states over democratic backsliding. With accession of a country, the EU loses its most effective tool for eliciting compliance which is membership itself. The quick adoption of liberal political

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53 Zielonka (2006), 1-10.
54 Ibid. 190.
55 Bozoki and Hegedüs (2018), 1178.
norms by Central and Eastern European countries mainly hinged on the EU’s promise to admit compliant members. Once this bar is cleared, the cost of non-compliance lowers considerably.\textsuperscript{56} Today, the most severe sanctioning tool for member states persistently in breach of values set out in Article 2 is the infamous Article 7 procedure suspending the voting rights of a member state in the European Council. Although, EU politicians like President Barroso have called it “the nuclear option,” it is really more like “moral quarantine” than actual intervention.\textsuperscript{57} The Treaty of the European Union does not provide a legal mechanism for actually removing a country from the EU, which would be an extreme measure but certainly increase the deterrence and therefore symbolic value over mere isolation. Even Article 7, however, will probably remain largely symbolic as it requires unanimity, and Poland pledged to veto any attempts to impose sanctions on Hungary in the Council.\textsuperscript{58} Infringement procedures following substantive breaches of EU law may in reality be more effective as these culminate in binding rulings of the European Court of Justice. The fact that legal recourse may not rectify the political issue at stake is still an issue, however, as exemplified by the ruling that found Hungary guilty of age discrimination when it forced judges to retire early. Instead of re-instating the judges, all the Hungarian government did was to compensate the retired judges which did not address the underlying concerns about judicial independence. This is what observers have called Orban’s “peacock dance” which signals moderation to EU interlocutors while not yielding an inch of his course at home.\textsuperscript{59}

Beyond formal legal procedures, the public shaming of Hungary in fora such as the European Parliament have also been ineffective and in some cases even counterproductive as it allowed Orban to highlight the EU institutions’ hypocritical treatment of Hungary. The Sargentini report criticizing Hungary’s anti-immigration laws, for instance, was adopted by the European Parliament in 2018 and was seen as a major success in reigning in Orban given broad-based support for the motion, even from Orban’s own faction, the European People’s Party (EPP). At home, however, Orban has been able to point with some justification to “the fact that his anti-refugee measures […] are finding understanding in more and more countries, even being mimicked.”\textsuperscript{60} There is also a sense that Hungary is being singled-out even though it has managed to reduce deficits to comply with the Stability and Growth pact – the main obsession

\textsuperscript{56} Schimmelfennig and Sedelmeier (2017), 2-6.
\textsuperscript{57} Müller (2013), 7.
\textsuperscript{58} Hopkins and Shotter (2018b), https://www.ft.com/content/b743c0b2-b6cd-11e8-bbc3-ccd7de085ffe.
\textsuperscript{59} Lendvai (2017), L.1641.
\textsuperscript{60} Ibid. L.1774.
of EU creditor states like Germany.\textsuperscript{61} It is therefore unsurprising that local observers have contended that “[w]hen the EU is facing its biggest set of challenges since World War II, it’s high time to take care of real problems instead of picking on economically successful member states.”\textsuperscript{62}

On the political front, support for the Hungarian government from allies seems to outweigh the pressure from the center. This lopsided relationship in favour of the autocrat is not unique to the EU but seems to be common in federations. In fact, there are many instances of sub-federal autocracies being able to survive within nationally democratic states due to the ability of allies at the federal level to fend off local opposition.\textsuperscript{63} According to Kelemen, the EU currently finds itself in such an “authoritarian equilibrium” where leading parties at the EU level are able to defend illiberal politics of member parties in their national polity. The only requirement of the local party is to support the overarching Europarty in the European Parliament and the Europarty, in turn, will publicly defend or at least not sanction its member party. On the other hand, opposition parties at the EU level are not allowed to fund or otherwise support their counterparts at the state level.\textsuperscript{64} The case of Fidesz within the EPP worked exactly according to this pattern. The chairman of the EPP, Manfred Weber, has, until recently, been a loyal supporter of Orban, defending his controversial handling of the refugee crisis as well as backing his electoral campaign in 2018.\textsuperscript{65} Fidesz gladly lent its eleven seats to the EPP and featured prominently among its leadership. It has only been recently with mounting pressure ahead of the European Parliament elections in May 2019 that Weber distanced himself from Orban and suspended Fidesz from the EPP. The decision is, however, more cynical than principled since Fidesz was only suspended from the European-wide party structure but not from the parliamentary group itself meaning that Fidesz MEPs will continue working and voting with the EPP. Weber’s soft touch with respect to Orban indicates that he would actually like to keep Fidesz within the EPP to ensure the party’s electoral victory but needs to deflect reputational damage from the EPP in order not to lose votes elsewhere.\textsuperscript{66} The bottom line is that in the absence of a strict hierarchical structure between an EU-level executive and state governments,

\textsuperscript{61} Matthijs (2019).
\textsuperscript{63} Gibson (2005), 103.
\textsuperscript{64} Kelemen (2017), 217-8.
Europarties can shield their members from intervention by lending credibility and preventing sanction.

Neo-medievalism is also present in the asymmetric economic benefits that Hungary derives from the EU’s economic set-up. On the one hand, the “four freedoms” of the Single Market, representing the EU’s “fuzzy” economic and physical borders, have enabled Hungary’s economic success under Orban through foreign direct investment and émigré remittances. On the other hand, the absence of any linkage between receiving cohesion funds and upholding EU law has undermined the EU’s ability to sanction Hungary’s transgressions.

First, Hungary has greatly benefited from the freedom of movement of capital and goods, having received large amounts of Foreign Direct Investment (FDI) with an FDI stock of 65% in 2017.\(^67\) The relationship of the Hungarian government towards foreign ownership in the economy is, of course, ambivalent as it has moved to renationalize banks and energy companies. Yet, Hungary actively invites foreign investment in the manufacturing sector where no local competition exists. Especially German carmakers have been taking advantage of Hungary’s relatively low labor costs and 9% flat corporate tax rate – the lowest within the EU. At an opening ceremony of an Audi plant, Orban highlighted that “Hungary is today inconceivable without the presence of Audi” while Audi’s CEO replied that the company felt “at home” in Hungary. This is not an isolated case among German businesses. In fact, a Hungarian observer noted that “[i]f German executives could vote, 90 percent of them would go for Orbán.” By quietly enjoying the EU’s economic freedoms without standing up for the values in which these are embedded, international corporations have been important enablers of Orban’s illiberal turn.\(^68\)

Second, due to the freedom of movement of people, many Hungarians have left their country for other European states. Since Orban came to power in 2010, almost half a million (overwhelmingly young) people have left Hungary, mainly for Great Britain, Germany or Austria.\(^69\) This emigrant wave has served a double purpose for the Orban regime. Most obviously, emigration represents citizen voting with their feet. As suggested by Hirschman, people dissatisfied with an organisation will chose to exit when it is not costly to do so. Free movement within the EU allows Europeans to relocate easily and acts as a “democratic safety valve and the opportunity to retract consent from one government.”\(^70\) The exit option that

\(^{69}\) Lendvai (2017), L.1774.
\(^{70}\) Moses (2017), 297.
Hungarian emigrants choose to signal discontent with the government is nonetheless not unfavourable to the political leadership as potential regime critics forgo a potentially more dangerous means of opposing the government, namely by raising their voices. By lowering the costs of exit, freedom of movement within the EU has removed hundreds of thousands of Hungarians, who are likely to be anti-Fidesz, from the political process. On top of lessening dissent, free movement also provides Hungary with hefty inflows of remittances from the Hungarian diaspora. Unlike in Hirschman’s economic example where consumer exit translates into lost revenue and prompts organizations to change, emigration may in reality be a positive sum game for Hungary. As shown in Figure 5, Hungary receives by far the highest share of remittances of all V-4 countries. At 3.5% of GDP, remittances are not a trivial position in the country’s current account and would have detrimental effects on growth if lowered significantly. It is also noteworthy that 95% of remittances to Hungary originate from within the EU. By comparison, intra-EU shares of remittances are only 53% and 43% for Germany and France, respectively. This points towards the significance of the freedom of movement within the EU as the major driver of remittances to Hungary.

Last but not least, the importance of EU transfers to Hungarian economic growth can hardly be overstated. Between 2007 and 2013, EU transfers amounted to €35 billion even exceeding FDI inflows for the same period. Cohesion funds alone reached €2.5-5 billion annually which equates to between 1.8-3.6% of Hungarian GDP. Given an average real GDP growth of 2.5% since 2000 and ignoring any multiplier effects from absorbed funds, it is evident that halting cohesion funds would immediately lead Hungary to fall into recession. The fact that economic success has been the main source of support for Orban’s “system change” suggests that cohesion funds could be used as a potential disciplining measure. Net-paying states have therefore been arguing to make disbursements of EU funds conditional on the compliance with fundamental values from the next budget cycle onwards. While this seems to be a sensible approach, it is quite problematic as Poland and Hungary point to the lack of a legal basis for introducing conditionality to EU funds, and such a move risks dividing the EU between “old” and “new” members. According to President Juncker, making funds conditional on rules would be “poison for the Continent.”

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71 Hirschman (1970), 23.  
73 Bank (2017), 29.  
74 Lendvai, (2017), L.1774.  
75 Halmai (2018).  
Conclusion

Hungary’s defiance of liberal democracy remains puzzling given the country’s membership of and high popular support for a Union that formerly requires respect for basic values and the maintenance of a market economy. This paper uses a two-level game approach to show how Fidesz was able to tighten its domestic win-set to obtain an outcome on their terms. The EU’s enabling and unconstraining structure did not allow it to credibly diminish its win-set and can thus hardly extract concessions from the Hungarian government. Focusing on the domestic and EU levels is important as it shows that both were necessary conditions for Hungary’s divergence from the liberal democratic model. At the Hungarian state-level, narratives created by Orban are important to explain how illiberal institutions could emerge in Hungary despite rising popular support for the EU. Yet, narratives are not sufficient if they do not meet fundamental constraints at the EU level. Hungary faced a very enabling and unconstraining environment as the EU’s non-hierarchical structure and “fuzzy” borders afforded Fidesz political protection alongside all the economic benefits of a member state. That constraints sometimes do become binding in the face of domestic narratives was recently exemplified by Greece. The left-wing populist party Syriza also created a narrative at home that defied EU creditor demands and proposed a solution to the Greek debt crisis other than through harsh fiscal conditionality. A referendum opposing a new Troika bail-out in 2015 was a clear attempt to rally support for Syriza and to tighten its win-set. Unlike the Hungarian case, however, the EU level was not enabling for Greece but, on the contrary, the Economic and Monetary Union turned out to be a “technocratic straightjacket” that allowed Greece no domestic flexibility to deviate from EU rules.77 Hence, ideas are a necessary but not sufficient condition for defying the EU from within.

Lessons that the EU can draw from the Hungarian case are that it is hard to compete on the ideational front once a narrative becomes entrenched at the domestic level. Making EU laws more constraining and strictly enforceable is also not a straightforward solution as many argue that it is this creeping expansion of EU competencies that Eurosceptics thrive on. A strengthened Article 7 sanctioning mechanism is also unlikely to offer a way out as its threat of “moral quarantine” has little deterrence value beyond the public shaming that Orban is already subject to. The most likely soft spot that might challenge Hungary’s experiment with illiberal democracy and economic nationalism is Orban’s inability to consistently provide high

77 Mathijs (2017), 284.
economic growth. Some cracks in the system are already visible as Hungary experiences a severe labour shortage forcing the government to pass very unpopular legislation which has led to mass protests. Once the economy turns sour, Orban’s defiance to the EU may not be long-lived.
Figure 1: EU vs. Orban approval ratings, Source: Eurobarometer & Gallup.

Figure 2: Illustration of Hungarian and EU win-sets. Hungary is able to narrow its win-set from H1 to H2, while the EU’s win-set remains the same, leading to an outcome closer to Hungary’s preferred outcome. Author’s graph.
Figure 3: Declining bank lending to the private sector. Source: IMF.

Figure 4: Views of Muslims in selected EU countries. Source: Pew Research Center.

Figure 5: Inbound personal remittances, % of GDP (2017). Source: Eurostat.
Bibliography:


